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SUBJECT: US/EU ENERGY SECURITY DISCUSSIONS

[1](#)1. (U) Summary. Under Secretary for Economic, Energy, and Agricultural Affairs Reuben Jeffery and Special Envoy Gray learned during February 12 meetings with EU Competition Commissioner Neelie Kroes, Energy Commissioner Andris Piebalgs, CFSP High Representative Javier Solana, and industry reps that:

-- EU Competition authorities are not sufficient to guarantee full competition in the gas and electricity transmission without the unbundling measures proposed in the Third Energy Package;

-- The purpose of the energy package is to enhance energy security -- including from major suppliers like Russia -- by increasing investment in grid interconnections and to add liquidity to the markets for gas and electricity;

-- The Commission would like to work more systematically with the US to pursue common interest on energy issues.

End Summary.

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Energy Security  
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[1](#)2. (U) On 12 February Under Secretary for Economic, Energy, and Agricultural Affairs Reuben Jeffery, Special Envoy Gray, and Econ Officers met with EU Commission officials to discuss energy security issues. In separate meetings with Competition Commissioner Neelie Kroes, Energy Commissioner Andris Piebalgs, and High Representative Javier Solana the officials highlighted the importance they place on energy security in the overall EU policy agenda.

[1](#)3. (U) The EU views energy security from both internal and external perspectives. Externally, Commissioner Piebalgs said the EU is looking to increase gas supplies from Norway, Algeria, Azerbaijan, the Arab Pipeline, and Iraq (specifically the Akkas field in Anbar Province). Piebalgs views LNG as another medium term solution for energy security but cautioned that Europe faces stiff competition, especially from China. LNG also has increased costs and technical difficulties compared to pipeline gas and the market for LNG is not as liquid as it could be. High Representative Solana indicated he also believes increasing LNG supplies from all sources will play an important role in enhancing EU energy security.

[1](#)4. (U) Piebalgs believes the Treaty of Lisbon should enable

the EU to transform its energy and external energy policy. Currently the only tools the EU can use to enforce energy policy are those related to the internal market or the environment. Piebalgs believes the role of the Energy Commissioner will be strengthened by the treaty.

15. (U) Internally the EU wants to increase competition and investment in its energy infrastructure. The goal is to establish a single liquid, competitive market for oil and gas to replace the current fragmented markets now found in the individual member states. The Commission's preferred tool to accomplish this is the Third Energy Package, proposed in September 2007. Commissioner Kroes stressed that the competition tools at her disposal are not sufficient to create the type of liberalized energy market Europe needs. She said she needs the backing of the Council and Parliament to impose real energy market liberalization, hence the Third Energy Package.

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The Third Energy Package  
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16. (U) Kroes believes that if the unbundling is successful the EU can get more investment and upgrade its infrastructure. Right now there are too few connections between member state grids. Kroes stated "There is no incentive for investment without unbundling." She believes the EU needs a fair and level playing field. Kroes views security of supply as a major issue within a common market. Kroes said she was dedicated to fighting for market liberalization in gas and electricity.

17. (U) On the question of unbundling, Piebalgs indicated that currently energy is a member state competence which

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results in 27 separate markets. The task is to deliver one market for electricity and gas. To do this the EU needs interconnection between the grids and a liquid market. Piebalgs feels the Third Energy Package is crucial. Unbundling is important, but Piebalgs does not view it as the most important part of the package. The most important part for Piebalgs is making sure that regulators in all 27 member states all have the same power and resources. Second, in Piebalgs view the EU needs to have cross-border regulatory balance. The EU Agency for Regulators has to make sure that there are no regulatory barriers to cross-border flows. Piebalgs ranks unbundling third in importance. He believes the EU needs structural unbundling with the networks separated from the suppliers.

18. (SBU) Piebalgs believes the EU can work with the recent counter-proposal to the Third Energy Package from France & Germany, which argues that application of existing competition policy tools should be sufficient and that unbundling, legal or de facto, is not needed. Kroes, however, is not satisfied with the counter proposal and believes the EU needs real unbundling. Piebalgs indicated the Commission will see how the other member states react and said the Commission could put additional requirements into the package. Piebalgs said the Commission needs the package, but not at any price. He expects a breakthrough by June; otherwise he feels the task will be left to his successor. Right now, however, he feels it is definitely too early to say.

19. (U) Addressing the question of third country investment in the EU energy sector, Commissioner Kroes said she believed investment from inside the EU and from the outside should be treated the same way. Kroes said she's delighted with US money, Norwegian funds, and Middle East investment, but that it has to be transparent when governments are the investors -- one of the reasons there is concern in the EU about the role of sovereign wealth funds. High Representative Solana also believes sovereign wealth funds will become very

important and believes this will not be an easy or uncomplicated issue. He sees the IMF and international cooperation playing an important role on this issue.

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EU-Russia Interdependence  
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¶10. (U) Solana, Piebalgs, and Kroes all emphasized the important role that Russia plays in the EU's energy security.

As Commissioner Kroes put it, "The EU is dependent on Russia, but Russia is also dependent on the EU. The EU needs Gazprom, but Gazprom needs the EU." High Representative Solana pointed out that Russia is the EU's most important supplier and Russia never failed as a supplier during the Cold War. Piebalgs also highlighted Russia's role as a dependable supplier. Nonetheless, Kroes indicated that the EU doesn't want to have all its eggs in one Russian basket. That's why the EU is interested in increasing supplies from Algeria and is pushing projects like Nabucco.

¶11. (SBU) The question for the EU is how reliable will Russian supplies be in the future. Solana expressed concern that the Russians have been "investing more on leverage than on pipelines, especially pipelines in Russia." According to Piebalgs, the current difficulty is over how the Russian gas sector is being managed. Piebalgs called the current situation an "unimaginable political mess" from a management point of view. At a meeting to discuss the Nabucco pipeline (see below), Howard Chase from BP indicated that BP believes Russia has systematically underinvested in its gas industry and cautioned that the cost for new Russian gas supplies will be at least twice as high as existing supplies.

¶12. (U) One hope for Russian gas production is if Russia can better manage its domestic market. Increasing prices and improving inefficiencies could allow Russia to free up more gas for exports. Solana finds Russia's attempts to tackle its domestic demand encouraging. Piebalgs was less optimistic but believes things are not as discouraging on the internal market as they are for investment.

¶13. (U) On the export front, Piebalgs pointed out that Russia is pushing a number of big projects such as Nord Stream and South Stream. Piebalgs sees South Stream as providing no new gas supplies for the EU, but at the same

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time doing no harm to EU interests. Piebalgs is pleased with the level of transparency for the Nord Stream project and categorized the Russians as working together with their European partners.

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Nabucco  
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¶14. (U) Piebalgs and Kroes both highlighted the important role they see for the Nabucco pipeline project in enhancing European energy security and emphasized the key role Turkey will play in deciding whether the project is successful. On the positive side, Nabucco recently added German RWE as its sixth partner and the Commission granted the necessary third-party-access exemption for the Austrian part of the pipeline.

¶15. (U) For Piebalgs the difficulty with Nabucco lies in sourcing. Nabucco is depending on Shah Deniz gas and Egyptian and Iraqi gas down the line. Piebalgs pointed out that the original idea behind Nabucco was Iranian gas but when this became politically unacceptable they started looking to Shah Deniz gas from Azerbaijan. Piebalgs does not exclude the possibility of getting gas from Turkmenistan, but categorized Turkmenistan as a "very particular country." He believes Trans-Caspian gas is not out of the question. The situation in Kazakhstan is more unclear.

¶16. (SBU) In a separate lunch meeting with officials from British Petroleum (BP) and Austrian OMV, Howard Chase, BP Director European Government Affairs, indicated production from the BP-operated Shah Deniz phase I is increasing and already at 9 bcm/year. This gas is already contracted to markets in Azerbaijan, Georgia, and Turkey. BP expects an additional 12-13 bcm/year from Shah Deniz Phase II. Azerbaijan and Georgia will want some of this gas, but it should leave 8 bcm/year to feed into Nabucco starting in 2013 onward, which will be enough to allow the project to go forward.

¶17. (SBU) Gottfried Steiner, Head of International Affairs for OMV, highlighted that Nabucco is a project that will have a portfolio of different supply sources. He acknowledged, however, that Nabucco needs the gas from Shah Deniz to make the first stage of the pipeline project viable. He expects a run on booking capacity once Nabucco is committed. He stressed that Nabucco is not anti-Russian and indicated that South Stream could be combined with Nabucco. Steiner said the motivation for South Stream is to avoid transit problems in Ukraine. Russia originally considered extending Blue Stream but found an unclear regulatory environment and legal regime in Turkey.

¶18. (U) Commissioners Kroes and Piebalgs both see Turkey as the critical part of the equation to make Nabucco work. Piebalgs believes it is essential that Turkey sort out the transit terms with Azerbaijan. According to Piebalgs, EU Nabucco coordinator Jozias Van Aartsen is very close to the Azerbaijanis and is working to close the negotiating gap. The good news is that Azerbaijan has absolutely no intention to ship gas via Russia. Commissioner Kroes also said the EU is watching Turkey closely. Until now Turkey has been cooperative, but that is not enough, Turkey needs to make its position clear. Whether the gas comes from Russia or Iran, it will have to come through Turkey.

¶19. (SBU) The BP and OMV representatives also emphasized that Turkey is key for Nabucco. Gottfried Steiner from OMV indicated that Azerbaijan's state company (SOCAR) has concerns over the transport regime in Turkey. Right now, there is no clear transport regime and no clear tariff. According to Steiner, Turkey has still not decided whether it wants to be a second Gazprom, buying gas on one end and then selling it on for a profit, or a gas transit state earning fees. Steiner pointed out that Turkey knows it is in a strategic position and they want to maximize their benefits out of it. However, they have not yet decided on exactly what these benefits should be. Howard Chase from BP agreed that Turkey suffers from a lack of "strategic clarity." Chase believes Turkey is the critical part of the whole equation. He is confident something can be worked out with Turkey. The Baku-Tbilisi-Ceyhan (BTC) project worked proving, according to Chase, that Turkey can make pipelines work if it wants to.

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The Role for Nuclear Power  
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¶20. (U) Both Solana and Piebalgs raised nuclear power as an important contributor to the EU energy mix going forward. Solana believes nuclear is not playing a large enough role in the EU picture, with the exception of France. He believes nuclear use has to increase EU wide. He also believes it may be time to take a fresh look at the non-proliferation treaty with the aim of enabling greater peaceful use of nuclear power worldwide. Piebalgs likewise believes now is the time to invest in nuclear energy. Solana also indicated that he does not believe Germany will go through with decommissioning its nuclear power plants because substitution will be too difficult in the context of the EU energy and climate change

targets.

¶21. (SBU) Solana highlighted that the EU is not alone in looking for new nuclear power plants. China and India are now competitive markets for nuclear power and over the past two years there has also been a large move toward nuclear power from the countries in the Mediterranean all the way across to Saudi Arabia. Piebalgs also raised the issue of Russian dominance in the nuclear power field. He indicated that the majority of new power plant tenders in the east seem to be going to Russia. Piebalgs finds this trend worrying, but has not determined if Russian dominance poses a real threat to EU energy security.

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US/EU Energy Relations  
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¶22. (U) Commissioners Kroes and Piebalgs and High Representative Solana all indicated that they find US engagement on energy security issues to be very positive. Piebalgs in particular encouraged the US to continue its current policies to build a free market in energy. Piebalgs believes the EU and US should have closer coordination on security of supply and that they should strengthen the role the IEA has to play. Piebalgs also agreed that the US and EU should work to have more coherent policy discussions and on a more systematic basis.

¶23. (SBU) Comment. U/S Jeffery's visit here helped set the stage for what should be a very productive March 3 US-EU Strategic Energy Policy Review. The Europeans in general share our aims of diversifying sources of supply and supporting the building of networks to bring gas from Central Asia and the Caspian region to Europe. They also appear amenable to collaborating with us as we work on some of the detailed steps needed to reach this goal: helping Turkey achieve clarity, enhancing investment climates, and working on legal issues with the governments concerned. We will want to develop a clear list of things on which we seek European input by March 3, so we can follow up with them subsequently.  
End Comment.

¶24. (U) U/S Ruben Jeffery cleared this cable with the exception of the USEU comment in para 23.

Murray

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